

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

NOTICE OF ADJUSTMENT OF RATES OF)	
4-WAY ENTERPRISES, INC., D/B/A)	CASE NO. 8493
COOLBROOK SEWAGE TREATMENT PLANT)	
TO BECOME EFFECTIVE APRIL 20, 1982)	

O R D E R

On March 31, 1982, 4-Way Enterprises, Inc., ("4-Way") filed an application with this Commission requesting authority to increase its rates by approximately \$28,839 annually, an increase of 102 percent. Based on the determination herein the revenues of 4-Way will increase by \$3,802 annually, an increase of 14 percent.

A public hearing was held in this matter on September 2, 1982, in the Commission's offices in Frankfort, Kentucky. The Consumer Protection Division of the Attorney General's Office was permitted to intervene.

COMMENTARY

4-Way is a privately-owned sewage treatment system serving approximately 212 customers in Franklin County, Kentucky,

TEST PERIOD

4-Way proposed and the Commission has accepted the 12-month period ending December 31, 1981, as the test period for determining the reasonableness of the rate approved herein. Appropriate pro forma adjustments have been included for rate-making purposes.

REVENUES AND EXPENSES

4-Way proposed several adjustments to revenues and expenses as reflected in its comparative income statement, exhibit C. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Revenues and Expenses Based on Plant Capacity

4-Way based several of its pro forma adjustments and its rate base on its plant capacity of 262 customers. Those expenses which 4-Way expects would vary with the number of customers were recalculated based on 262 customers.

The Commission is of the opinion that the adjustments to reflect the cost of serving additional customers based on the full capacity of the treatment plant are not justified herein. No evidence was presented by 4-Way to substantiate its conclusion that the various costs which were adjusted are affected in proportion to the number of customers served by the system. Some of the expenses adjusted by 4-Way are not related to the number of customers served. Therefore, the proposed adjustments to revenues and expenses based on 262 customers have been denied herein. The Commission has, however, in some instances allowed increases in expenses based on known and measurable cost increases as more specifically set out herein.

Increase in Maintenance Expenses

4-Way proposed to increase several of its expenses by a flat 10 percent. The explanation given in support of this adjustment was "expected price increase over test period." In an attempt to support these adjustments 4-Way introduced as evidence several letters from its suppliers concerning price increases. While 4-Way proposed to increase seven different expense accounts by 10 percent, letters were supplied only from 4-Way's routine maintenance service company, electric utility, and sludge hauling company. The routine maintenance service company and electric utility could state only that an increase is anticipated, while the sludge hauling company stated that a \$5 per load increase will be effective immediately.

The Commission finds that those adjustments based on a flat 10 percent increase are not sufficiently known and measurable and has disallowed them in accordance with its previous policy.

In view of the letter documenting the increase in sludge hauling expense the Commission has made an adjustment increasing sludge hauling expense by \$35 to reflect the increased cost.

Rate Case Expenses

4-Way proposed an adjustment of \$483 for rate case expenses. This adjustment represents the amortization of an estimated \$1,450 fee over a 3-year period. The Commission requested and 4-Way has supplied the final invoices from its accountant and legal counsel in connection with this case. The expenses total \$1,950. The Commission in accordance with past practice has amortized this expense over a 3-year period which results in an adjustment of \$650.

Utilities Expense

4-Way proposed an adjustment to utilities expense of \$4,442, based on the full capacity of the treatment plant and a 10 percent increase for inflation. In computing the utilities expense for 4-Way, the Commission has determined the actual level of KWH and gallon usage from the test year utility bills and has applied the most current rates in effect to these usage levels. Based on this analysis the Commission has determined 4-Way's pro forma utilities expense to be \$11,153, which is an increase of \$1,080 above the test year actual expense.

Billing and Collecting Expense

The Commission is of the opinion that the fee paid to Farmdale Water District ("Farmdale") for billing and collecting for services rendered by 4-Way is excessive based on the actual costs incurred by Farmdale and based on a comparison of the expenses of other utilities with similar billing arrangements.

Farmdale provides billing services for 4-Way and other sewer utilities within its service area based on a percentage of gross receipts. From the information contained in Farmdale's annual report it is clear that it is collecting revenue substantially in excess of the cost of providing this service. The Commission is of the opinion that a just and reasonable fee should be based on actual costs rather than a percentage of 4-Way's gross receipts. In accordance with its decision in Case No. 8102, Farmdale

Development Corporation's rate case, the Commission has allowed a flat rate of \$1.00 per bill which it finds is a fair, just and reasonable fee for 4-Way to pay Farmdale based on Farmdale's cost of providing this service. The Commission finds the present contract between 4-Way and Farmdale not in the best interest of the public. For these reasons the Commission urges 4-Way to renegotiate a contract representative of the amount found reasonable above.

Equipment Replacement

During the test period 4-Way purchased 2 new air compressors at an installed price of \$675, and rebuilt the rotating elements in its raw sewage pumps at a cost of \$1,675. 4-Way included these costs in non-routine maintenance expense in 1981. In accordance with generally accepted accounting principles, the Commission has capitalized both expenditures, which results in a reduction of operation and maintenance expenses for rate-making purposes herein. These items of plant should be depreciated over an estimated useful life of 5 years, resulting in annual depreciation expense of \$470.

After removing these items from non-routine maintenance expense the balance in that account will be \$999 for rate-making purposes.

Interest Expense

During the test year 4-Way reported interest expense of \$8,338 and a pro forma adjustment was proposed to increase the annual interest expense to \$9,571 based on debt outstanding at the end of the test period. In calculating the pro forma interest expense 4-Way

applied a 12 percent interest rate to a \$50,000 note, \$12,898 of accrued interest, and \$16,857 of open loans. All of these liabilities are reported in 4-Way's annual report under notes payable and are indentified as "4-Way-Durham Joint Venture." Mr. Carl Sturgeon, President, stated that these obligations are to its parent company.

Because of the corporate relationship between 4-Way and its parent the loans outstanding are not at arms length and, therefore, must be scrutinized by this Commission. Furthermore, this Commission has not authorized any financing for 4-Way.

The proposed interest expense in this case consists basically of two parts: interest on the original note of \$50,000 and accrued interest of \$12,898 on that note, and interest on the open end loan of \$16,857.

Mr. Zalaman Weinberg, accountant for 4-Way, testified that when the joint corporate operations of 4-Way and its parent were separated, the owners determined that a liability should be established on the books of 4-Way to reflect the capital associated with the value of the sewage treatment plant, which was set at \$50,000. At the time this liability was put on the books of 4-Way an offsetting debit entry was made to Other Paid in Capital, Account 207. The Commission finds no justification in the Uniform System of Accounts or in generally accepted accounting principles for these accounting transactions.

Upon a request for documents relating to the initial \$50,000 note payable, 4-Way provided only a letter from a local bank which stated the estimated value of the sewage treatment plant for the purposes of securing a loan. No evidence of indebtedness to any lender has been provided. Since 4-Way has not proved the validity of this indebtedness in this case the Commission has excluded any interest expense for rate-making purposes herein. Moreover, the Commission finds that 4-Way should make the appropriate journal entries to remove these current liabilities and the debit balance in Account 207, Other Paid in Capital, from the books of account.

The \$16,857 of open loans included in the calculation of interest expense has, likewise, not been supported in this case by any evidence of indebtedness nor authorized by this Commission. Mr. Sturgeon testified that these loans were made to 4-Way to finance cash operating deficits from previous years of operations. The burden of obtaining sufficient revenues to pay operating costs clearly rests with the management of 4-Way. The failure of 4-Way to seek sufficient revenues to cover its operating costs in prior periods does not justify the request in this case to recover these costs from the present ratepayers. To allow 4-Way to recover these costs or the finance charges on these funds would constitute retroactive rate-making by this Commission. Therefore, we have excluded interest on the \$16,857 open loan for rate-making purposes herein.

Income Taxes

Although 4-Way did not propose an adjustment for federal and state income taxes the Commission has included a provision of \$871 for taxes, based on the level of net income allowed herein and the applicable federal and state income tax rates.

Based on the allowed pro forma adjustments, 4-Way's test period and adjusted operating statement appears as follows:

	<u>Actual 12/31/81</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Year</u>
Operating Revenues	\$ 28,139	\$ -0-	\$ 28,139
Operating Expenses	27,555	553	28,108
Net Operating Income	\$ 584	\$ (553)	\$ 31
Interest Expense	8,338	(8,338)	-0-
Net Income	<u>\$ (7,754)</u>	<u>\$7,785</u>	<u>\$ 31</u>

The Commission is of the opinion that the operating ratio⁽¹⁾ of 88 percent proposed by 4-Way is fair, just and reasonable and should be used in this case. It will permit 4-Way to pay its operating expenses, service its debt and provide a reasonable return to its owners. Therefore, the Commission finds that 4-Way is entitled to increase its rate to produce total revenues of \$31,941 which will require an increase in revenues of \$3,802 annually.

(1)
$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenue}}$$

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

(1) The rate in Appendix A is the fair, just and reasonable rate for 4-Way and will produce gross annual revenue sufficient to pay its operating expenses, service its debt and provide a reasonable surplus for equity growth.

(2) The rate proposed by 4-Way would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rate in Appendix A be and it hereby is approved for service rendered by 4-Way on and after the date of this Order.

IT IS FURTHER ORDERED that the rate proposed by 4-Way be and it hereby is denied.

IT IS FURTHER ORDERED that within 30 days from the date of this Order 4-Way shall file with the Commission its revised tariff sheet setting out the rate approved herein.

Done at Frankfort, Kentucky, this 4th day of November, 1982.

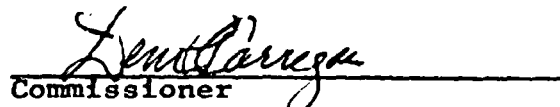
PUBLIC SERVICE COMMISSION


Chairman

ATTEST:


Vice Chairman

Secretary


Commissioner

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY
PUBLIC SERVICE COMMISSION IN CASE NO. 8493
DATED NOVEMBER 4, 1982

The following rate is prescribed for customers in the area served by 4-Way Enterprises, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this Order.

<u>Service</u>	<u>Monthly Rate</u>
Single Family Residence	\$12.56